

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

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Telephone Number:

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CC:PSI:B03 – PLR-104439-04

Date:

July 28, 2004

LEGEND

Company =

State =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

X =

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Dear _____ :

This letter responds to a letter written on behalf of Company, dated January 14, 2004, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

Company incorporated on Date 1 under the laws of State. Company elected to be an S corporation effective Date 1.

Under Company's Articles of Incorporation, Company was authorized to issue common stock. On Date 1, Company issued shares of common stock equally to each of its three shareholders, Shareholder 1, Shareholder 2, and Shareholder 3.

Shortly after Date 1, Company's legal counsel recommended that the Articles of Incorporation be amended to provide for the issuance of preferred stock. On Date 2, the Articles of Incorporation were amended, and Company issued shares of preferred stock equally to each of its three shareholders. The shareholders did not contribute any money or property to Company in exchange for the preferred stock. The preferred stock provided for different distribution rights than the common stock.

On Date 3, Shareholder 3 sold all of his shares of Company common stock and preferred stock equally to Shareholder 1 and Shareholder 2. On Date 4, Company redeemed and canceled Shareholder 2's common stock and preferred stock. On Date 5, Shareholder 1 transferred X percent of his common stock and preferred stock to Shareholder 4.

Around Date 6, Company retained new legal counsel who discovered that Company may have inadvertently terminated its S corporation election on Date 2 by issuing a second class of stock. On Date 6, Company took corrective action by redeeming the preferred stock and amending the Articles of Incorporation to eliminate the preferred stock.

It is represented that at all times since Date 1, Company has made distributions on the basis of the ownership of Company's common stock and that no distributions have been made with respect to the preferred stock. All of Company's income and expenses have been reported by the shareholders in proportion to their ownership of the common stock of Company.

Company represents that it did not intend to create more than one class of stock. As soon as Company realized the potential problem caused by the preferred stock, Company eliminated the preferred stock. Company and its shareholders agree to make any adjustments, consistent with the treatment of Company as an S corporation, as might be required by the Secretary.

Company requests a ruling that under § 1362(f) Company's S corporation election was inadvertently terminated, therefore, Company will be treated as an S corporation effective Date 2 and thereafter.

LAW

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1)(D) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that, a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to that period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based on the facts represented and the information submitted by Company, we conclude that the issuance of the second class of stock terminated Company's S corporation election on Date 2. We also conclude that the termination of Company's S corporation election was inadvertent within the meaning of § 1362(f). Therefore, Company will be treated as continuing to be an S corporation from Date 2 and thereafter provided Company's S corporation election was not otherwise terminated under § 1362(d).

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This ruling is contingent on Company and its shareholders treating Company as an S corporation for the period beginning Date 2 and thereafter. Accordingly, the shareholders of Company must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company to the shareholders under § 1368. If Company or its shareholders fail to treat Company as described above, this ruling will be null and void.

Except for the specific ruling above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code, including whether Company is otherwise eligible to be an S corporation.

Under a power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

/s/

Christine Ellison
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: